

IN THE  
**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

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RONALD E. GATES,

*Appellant,*

*v.*

P. F. COLLIER, INC.,

*Appellee.*

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APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF HAWAII

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**BRIEF FOR APPELLEE**

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**BRIEF FOR APPELLEE**

**Statement**

Plaintiff-appellant Ronald E. Gates appeals from judgment of the United States District Court for the District of Hawaii, Martin Pence, C.J. sitting without a jury. After ten days of trial, the Trial Court awarded defendant-appellee P. F. Collier, Inc. damages, special costs and interest in the amount of \$306,676.25 on its counterclaims for fraud, breach of fiduciary duty and breach of contract.

The Trial Court's Amended Decision in support of the judgment is reported at 256 F. Supp. 204.

## **Facts**

### **(1) The Basic Facts Are Uncontroverted**

Appellant's brief omits a statement of facts pertinent to his appeal. For this reason, appellee sets forth below a statement of facts proved at trial. These facts fully support the findings in the Trial Court's Amended Decision (Rec. 688-711).

### **(2) The Parties: Their Relationship 1954-1960**

In 1954, appellant Ronald E. Gates ("Gates"), President of R. E. Gates & Son Company, Ltd. ("Gates Company"), was engaged in selling books in Japan (Tr. 69, Rec. 688). Appellee's predecessor, P. F. Collier & Son, Inc. ("Collier"), a Delaware corporation engaged in selling sets of encyclopedias and other reference texts, was then expanding its overseas sales (Tr. 744). At that time, Gates Company entered into an oral agreement with Collier to purchase Collier encyclopedias and sell them at a price within its discretion for its own account (Tr. 251-252, 737).

This arrangement continued until 1959, when Collier entered into written agreements with Gates Company authorizing Gates Company to sell Collier publications on a commission basis to United States military personnel stationed in certain areas of the Far East (PX 4; Tr. 246, 738). At the same time the purchase and sale agreement on civilian transactions was put into writing (PX 5; Tr. 197, 228, 246, 737). By April 1960 Gates Company was indebted to Collier on book purchases for \$68,036.91 (Tr. 149, 291, 738). In spite of this indebtedness, Gates Company sought further credit from Collier (Tr. 739), but Collier refused (Tr. 288).



### **(3) The New Japan Branch Operation**

As an alternative, Collier proposed to set up its own branch operation in Tokyo with Gates as Branch Manager and with accounts receivable to be accounts receivable of Collier rather than of Gates Company (PX 9; Tr. 195, 196, 201, 227, 278). Gates agreed to this proposal and Collier registered its Japan branch as a branch of a foreign corporation doing business in Japan (Tr. 12, 347). Collier paid the requisite Japanese taxes for the taxable periods beginning April 26, 1960 (Tr. 824). Gates was listed as the "registered representative" of Collier in Japan (Tr. 139).

### **(4) The Contract and The Procedure**

On April 15, 1960 Collier entered into a written agreement with Gates *individually*, wherein Gates personally undertook to account to Collier for books received from Collier and money collected and due from customers (PX 1; Tr. 197-198, 364, 780, 986, 1000-1001).

After the reorganization of P. F. Collier & Son in 1961, the contract with Gates was assigned to P. F. Collier, Inc., the successor corporation (PX 3). On September 15, 1961 P. F. Collier, Inc. (also referred to herein as "Collier") and Gates entered into a new contract substantially identical to the April 15, 1960 contract (PX 1, PX 2). These contracts were negotiated and drafted in New York (Tr. 9-10). Collier executed the contracts in New York; Gates executed them in Tokyo (Tr. 9-10).

While the April 15, 1960 contract was in preparation, a document was drawn entitled "Procedure for Opening Tokyo Branch Japan" ("Procedure") (PX 9). The Procedure set forth rules governing the operation of this branch as well as the compensation to be paid Gates as

Collier's Japan Branch Manager (PX 9). Gates participated in the development of the Procedure and understood its provisions (Tr. 1009).

#### **(5) Gates' Contractual Responsibilities**

The April 15, 1960 contract specified the responsibilities Gates undertook to perform (PX 1). Gates was to act as Far Eastern Sales Supervisor of Collier's Japan branch with headquarters in Tokyo (Tr. 201, 202). He was restricted in the geographic area in which he might sell Collier publications (Tr. 132). He was required to forward all orders to Collier's New York office within ten days after receipt (Tr. 203-204, 209); Collier in New York could accept or reject any order (Tr. 82). He was required to deposit all collections in Collier's account at First National City Bank of New York in Tokyo ("FNCB Tokyo") (Tr. 80, 143, 206, 801, 1013). He had no discretion to withhold Collier money (Tr. 800-801). He was not permitted to use the name of Collier in any printed or written material without Collier's approval (Tr. 211-212). He was not permitted to assign the agreement without Collier's consent (Tr. 207). And, further, he was obligated to account for expenditures made on behalf of Collier (Tr. 1014).

#### **(6) Gates' Specific Obligations**

Pursuant to the Procedure (PX 9), Gates was required: (1) to send to Collier each month a list of checks drawn and their amounts (Tr. 212); (2) to send to Collier each month a statement reconciling Collier's bank statements at FNCB Tokyo (Tr. 213); (3) to allow an independent audit of the Japan branch at least once every six months (during the first year of the Japan branch operation an audit was to be made every three months) (Tr. 214);

(4) to follow a price schedule established by Collier (PX 9); and (5) to remit to Collier in New York on a daily, weekly and monthly basis, completed Collier forms detailing the books sold, collections made, collections remitted, commissions received, stock on hand and other relevant information to inform Collier in New York as to the exact status of the business of its Japan branch (Tr. 142, 210-211, 741, 1010, 1042, 1061, 1083, 1085).

As of the new contract date, April 15, 1960, Gates' business correspondence was transmitted on Collier's letterhead; previously he used the letterhead of Gates Company (Tr. 202). Further, as of this date, for the first time, Gates' responsibilities included the collection of money due and owing to Collier and the handling of stock merchandise belonging to Collier (Tr. 199). For that reason, Collier then obtained a \$50,000 fidelity bond on Gates as its employee (Tr. 198, 199, 1131).<sup>\*</sup> Similar bonds were issued in 1961 and 1962 (Tr. 215). In November 1961 Gates was appointed a Vice President of Collier (Tr. 202, 215, 322, 742, 1130).

The September 1961 contract added the Republic of the Philippines to Gates' territory and early in 1962 the parties orally agreed to add Australia (PX 2). On March 1, 1962, because of an increasingly bad collection record on sales to U. S. military personnel (Tr. 119), Collier and Gates signed an agreement transferring from Gates to Collier the collection responsibilities on such sales (PX 6).

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<sup>\*</sup> Not until after discovery of Gates' embezzlement and his dismissal by Collier in 1962 was Collier aware that appellant Gates had been convicted three times in American courts for obtaining property under false pretenses (Tr. 1185, 1189-1190).

**(7) Accounting Breakdown of Sales Under the 1960 and 1961 Contracts**

For accounting purposes, Collier sales transactions in the Far East were as follows (Tr. 122):

- (a) 96B—sales to U. S. military personnel for U. S. dollars;
- (b) 97B—sales to Japanese civilians in yen;
- (c) 98B—sales in Australia in Australian pounds; and
- (d) 99B—sales to Japanese schools in yen.

On sales to U. S. military personnel, Collier shipped the books directly from New York to the purchaser through the Army Post Office Service (Tr. 123-124). Payments for such purchases were made in U. S. dollars and forwarded directly to New York (Tr. 119). Books sold to Japanese civilians and schools were imported into Japan under import licenses issued to Collier by the Japanese Government (Tr. 15-16) and collections in yen were deposited in Collier's FNCB Tokyo account (Tr. 16). These yen were subsequently converted into U. S. dollars and transmitted to New York under the Japanese import licenses (Tr. 16).\*

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\* Collier's General Superintendent Simon J. Nork testified as follows regarding the reasons for the increase in the amount of foreign exchange requested under the import licenses after Collier and Gates entered into the 1960 and 1961 contracts (Tr. 108-109):

"Q. Now, with relation to this \$69.00 [the price at which Gates bought a set of encyclopedias from Collier before the 1960 and 1961 contracts] and the \$153.00 [the import license figure excluding collateral books], will you explain to us why there is that difference? A. We agreed upon this price in view of the fact that now we had to pay the cost of freight and insurance to get those books to Tokyo. Previously Gates paid those.

Now, when we sold the books outright to Gates, we didn't have to maintain a clerical staff. Now we have to maintain a clerical staff to keep records.

### (8) Gates' Fixed and Contingent Commissions

Pursuant to the contracts and the related Procedure (PX 1, PX 2, PX 9), Gates was to receive the following *fixed* and *contingent* commissions:

(a) a fixed "sales commission" of 34% (36% in Australia) of the net sales price (gross sales price less service charge) immediately upon the acceptance of the order by Collier regardless of the amount of down payment (Tr. 96, 113, 157-158, 174, 227, 325-326);

(b) a contingent "collection commission" of 7% of the net sales price on each individual order where 50% of the purchase price was paid by the customer within 15 months from the date the order was accepted by Collier (Tr. 17, 96, 98, 110, 227, 407);

(c) a 12.5% gross sales fund (10% on sales to Japanese schools after September 15, 1961), which, contingent upon the existing "loss ratio," could result in a commission to or a liability of Gates. Collier undertook to determine the amount to be characterized as a "loss" 30 months after the month the business was reported on 24-month contracts, and 15 months after the business was reported on 12-month contracts; this analysis was to be made

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Q. Clerical staff where? A. In New Hyde Park and in New York. And in addition to that, our editorial cost has gone up. So all this calculated into this \$153.

Q. This was all because of the cost to you, am I right?

A. This is the amount we agreed upon that it would cost us under this new arrangement in 1960." See also DX R-2—R-47.

The Trial Court found (Rec. 701):

"Nowhere did the plaintiff prove, or even attempt to prove, the actual cost or cost plus profit of any set of books landed and sold in Japan."

Furthermore, at trial plaintiff Gates never established the relevance of this cost figure.

on a month-by-month basis (Tr. 99, 110, 115, 379, 385, 399, 430, 435, 437, 466). For example, in November 1961 Collier would analyze all 12-month contract sales made during the month of July 1960, characterizing those not paid in full as "losses" and thus determining the "loss ratio" for the month of July 1960. If this amount of loss was lower than 12.5% of the gross sales for the month, Collier would pay Gates the difference as a bonus for securing good paying customers. On the other hand, if the amount of loss for the particular month exceeded 12.5%, Gates would owe the difference to Collier. Thus, Collier undertook either to absorb as a loss or to pay as a bonus 12.5% of all sales. During trial, Gates conceded that this was a proper method of analysis (Tr. 385). And see the Trial Court's findings (Tr. 379, 399, 466; Rec. 689-690);

(d) an incentive bonus sale commission of 1% of the net book sales if gross book sales by Gates during a 12-month period exceeded \$500,000, but were less than \$1,000,000, and a similar commission of 2% if gross sales exceeded \$1,000,000 (Tr. 99, 126); and

(e) by subsequent oral agreement, a 5% additional commission which Gates in his discretion could allow as a discount to a customer or retain for himself if the customer paid the full purchase price within 30 days (Tr. 114, 121, 227, 283, 409).

#### **(9) Gates' Fraudulent Scheme Began in April 1960**

Between April 1960 and April 26, 1962, Gates was Far Eastern or Asian Sales Supervisor of Collier and in this capacity collected certain money belonging to Collier on cash sales of Collier publications (Tr. 742-744, 798, 1173). 1,095 of these sales were actually cash sales for the entire purchase price, which Gates reported to Collier as installment sales to fictitious purchasers, concealing the true



nature of the sale (DX B-13—A, B, C). Gates remitted to Collier false down payments as if these sales had been installment sales, wrongfully pocketing the balance of the lump-sum purchase price which he had collected from the customer (DX B-13—A, B, C).

In order to maintain consistent reporting of the fraudulent sales, Gates held a conference with his staff on his return from New York in April 1960 and ordered certain false ledgers to be prepared and maintained (PX 101, DX B-13—A, B, C; Tr. 554, 597, 598, 604, 605, 627, 690, 696, 812, 1002, 1167). These false ledgers were kept partly in English and partly in Japanese (Tr. 1038). Collier never knew of these fake ledgers or the fraudulent reporting system until they were discovered by its officers on April 26, 1962 (205, 218, 744-745, 811).

#### **(10) Dummy Purchasers**

In continuance of his scheme and to conceal further the true nature of the transactions from Collier's auditors, Gates obtained through his staff the cooperation of various individuals in Japan whom he listed as purchasers on the fictitious installment contracts (PX 101; Tr. 603, 610, 612, 637). These dummy purchasers were instructed, upon receipt of a confirmation letter from Collier's auditors, to turn the letter over to Gates in order that it might be answered in harmony with the false information reported to Collier by Gates (PX 101; Tr. 618, 814).

#### **(11) Collier's Discovery of Gates' Fraudulent Scheme**

In the spring of 1962, Collier discovered that there was a steady increase in reported installment sales, combined with a decrease in cash purchases (Tr. 746, 747, 794). Collections from sales were falling off rapidly (Tr. 746, 747, 794). Collier also noticed that payments

from Japanese civilians were being reported in blocks, with the same purchasers "paying" on the same day of each month—an unusual occurrence (Tr. 763-764).

At a conference at Collier's New York office in April 1962, Norman B. Bennett, then Senior Vice President of Collier (now President), was designated to go to Tokyo to find out what was wrong at Collier's Japan branch (Tr. 747).

On Tuesday evening, April 24, 1962, Gates met Bennett at the Tokyo Airport (Tr. 541, 748). Enroute to the hotel, Gates told Bennett of his desire to cooperate in the investigation of the Japan branch (Tr. 748). He advised Bennett that he had discovered something wrong, was inquiring into the situation and would have the results of his inquiry the following morning (Tr. 543, 748).

The next morning Gates telephoned Bennett, saying he would need more time to complete his investigation (Tr. 543, 748). He asked postponement of their meeting until the following day (Tr. 541, 748, 1164).

On Thursday morning, April 26, 1962, Bennett went to Gates' office accompanied by Robert B. Van Arsdale, Resident Partner of Deloitte, Plendor, Haskins & Sells, Collier's auditors in Japan (Tr. 748-749, 810). Gates told them that he had discovered that his Japanese accountants had been keeping "secret ledgers", which he turned over to Bennett (Tr. 540, 557, 749, 750, 812). Gates explained that these ledgers recorded the legitimate cash purchases which were falsely reported to Collier as installment sales (Tr. 558, 812). Gates indicated that there might be a shortage (Tr. 558). Gates admitted to Bennett and Van Arsdale that such a scheme was completely wrong, and that neither Gates nor anyone working for him had a right to this money (Tr. 755, 815). Gates said he wished



to cooperate in every way in accounting for the money withheld from Collier (Tr. 559).

### **(12) Gates' Admission of Fraud**

On Friday, April 27, 1962, Bennett and Van Arsdale returned to Gates' office (Tr. 813). Gates asked to see Bennett alone, but Bennett refused (Tr. 752, 814). Bennett and Van Arsdale then entered Gates' private office (Tr. 752). Gates said that the day before he had withheld certain information from them, that he had himself created and maintained the secret ledger system, and that he was responsible for the money wrongfully retained (Tr. 563, 753, 770, 814, 999, 1027, 1077). Bennett asked Gates why he had done this (Tr. 755). Gates replied that the system enabled him to obtain money he needed for the Japan branch operation (Tr. 755). Gates again admitted this was wrong (Tr. 755, 779, 815). Gates added that he had created the secret ledger system in order to repay Collier the \$68,036.91 debt owed by his company (Tr. 755). He stated that he was personally responsible for repaying to Collier the money withheld (Tr. 755, 815, 1160). He requested permission to inform the fidelity bond company of his defalcation (Tr. 756, 815, 1165).

### **(13) Gates' Turnabout of His Confession**

On Saturday, April 28, 1962, Bennett and Van Arsdale returned to Gates' office (Tr. 757). Gates repeated his desire to repay Collier (Tr. 756, 757). On Tuesday, May 1, 1962, Bennett went to Gates' office to examine Collier records to determine the amounts due Collier (Tr. 758). Gates entered the office and told Bennett that he had been checking his records and had concluded that he had done nothing wrong, and that any further communications with him must be made through his lawyer (Tr. 566-567, 758).

Although Bennett had the "secret ledgers" at his hotel, Gates prevented Bennett from removing from Gates' office the remaining records of the Japan branch operation (Tr. 548, 549, 554, 561, 568, 759, 835, 836).

**(14) Collier Discharged Gates and Terminated Their Relationship**

The Board of Directors of Collier had met on April 26, 1962 and voted to discharge Gates (DX B-16; Tr. 759). On May 2, Bennett handed Gates a letter (DX B-17) confirming Gates' discharge from Collier and termination of his contract (Tr. 21, 759-760, 1315). Gates took the letter and gave it to his attorney (Tr. 760). A copy of the letter was also sent to Gates by registered mail (Tr. 760). As Bennett testified, Gates was discharged by Collier for all purposes (Tr. 166, 172, 762). Bennett then struck Gates from the rolls as Collier's registered representative in Japan on May 9, 1962 (DX B-19; Tr. 761).

**(15) Gates' False Statements After His Discharge**

Following discovery of the fraud, Gates sought to obfuscate his discharge and the open account between himself and Collier by seeking on a manifestly false affidavit an *ex parte* order from a Tokyo court precluding Bennett and S. J. Nork (Collier's General Superintendent) from acting as Collier agents in Japan (Ct. Ex. A, DX G-1, G-34-A; Tr. 181, 804, 1015-1037). At the same time, Gates pretended that he still represented Collier in Japan, and sold books and collected cash on account for his own use (Tr. 947).

**(16) Gates Owes Collier \$169,013 Under the 1960 and 1961 Contracts**

The excess amount collected under Gates' scheme was not deposited in Collier's bank account as required by the contracts (Tr. 818). As the purported installments became due, Gates would pay these amounts to Collier, but when Collier discovered Gates' scheme and terminated his contract and employment, \$169,013 of Collier money was still unreported and unremitted by Gates (DX R-48).

All the Collier business records utilized in calculating this amount were introduced into evidence (DX R-2 through R-47) as were accounting summaries reflecting these records (DX R-1, R-48 and PX 108). This information was prepared by Allan Rabinowitz, Manager of the Accounting Controls Department of Crowell Collier & Macmillan, Inc. (Tr. 849), a C.P.A. (Tr. 850) and a Professor of Accounting at Pace College (Tr. 851).

**(17) Gates Owes Collier \$38,403 for 251 Sets of Encyclopedias Unaccounted For**

During the term of the contract, 2,500 sets of Collier's Encyclopedia were shipped to Gates in Japan under the import licenses (Tr. 991, 1134, 1137). One hundred of these sets arrived in Japan after Gates' contract had been terminated; nevertheless Gates took possession of these 100 sets (Tr. 946). Gates has failed to account for 251 of the 2,500 sets (DX B-17; Tr. 946, 950; Rec. 705). The wholesale value of this merchandise in Japan on the date of conversion was \$38,403 (Tr. 1344; Rec. 705).

**(18) Gates Owes Collier \$9,000 on Unpaid Loans**

On December 14, 1961 and March 14, 1962 Collier made Home Office Loans to Gates personally at his request, each

in the amount of \$5,000 (DX G-35; Tr. 1110, 1114). To date Gates has paid only \$1,000 on these loans totalling \$10,000, thus leaving an outstanding balance of \$9,000, which amount became payable on the termination of Gates' contract (DX G-31; Tr. 1118).

**(19) Collier Incurred Reasonable and Necessary Expenses of \$11,011.99 As a Direct and Proximate Result of Gates' Wrongdoing**

Immediately after the defalcation of Gates was discovered, Collier incurred travel and related expenses in its effort to settle and clarify Gates' status prior to Collier's attempt to reestablish a new sales organization (Tr. 1206-1208, 1249-1252, 1268, 1271). These expenses, which totalled \$11,011.99, are limited only to the expenditures made by Bennett and Nork in trips to Japan and Australia immediately after the termination of Gates' contract, and do not include other expenditures incurred by Collier on account of Gates' defalcation (Rec. 709).

**(20) Gates' Misconduct Caused Collier to Incur Reasonable Attorneys' Fees of \$25,000**

In addition, Collier has incurred legal and audit expenses of \$78,000 (DX B-23), which includes payments to Collier's auditors and attorneys in New York, Hawaii, Japan and Australia (Tr. 1252-1254). The Trial Court found that \$25,000 of these expenses were directly related to the legal proceedings in Hawaii and Japan, including: an action by Collier to attach Gates' property in Tokyo; an action by Collier against Gates for damages arising out of Gates' defalcation; defense of Gates' action against Collier officers Bennett and Nork; and certain pre-trial expenses of the instant case (Rec. 706-709). The Trial

Court found that these expenses were incurred as a result of Gates' fraud and the institution by Gates of vexatious litigation, and that the figure of \$25,000 was a figure which Collier could not reasonably recover in any other litigation now pending (Rec. 707-708).

**(21) Judgment For Collier on Its Counterclaims  
Against Gates—\$306,676.25**

In 1963, Gates fled Japan and entered Hawaii (Rec. 696). He initiated this suit on July 9, 1964, demanding \$367,183 as purported commissions (Rec. 1-5). On July 30, 1964, Collier's counterclaims for \$833,290 were filed (Rec. 27-33). On April 18, 19, 20, 21, 22, 25 and 26, and June 1, 2 and 3, 1966, the case was tried before Judge Pence without a jury. By an Amended Decision dated July 8, 1966, Judge Pence found in favor of Collier on the counterclaims in the amounts of \$169,013 (unaccounted for under the contracts), \$38,403 (Collier's Encyclopedias unaccounted for) and \$9,000 (debt), all with 6% interest from May 2, 1962 through July 6, 1966, together with \$11,011.99 (necessary Collier expenses caused by Gates' conduct) and \$25,000 (reasonable attorneys' fees), a total judgment of \$306,676.25 (Rec. 686-711).

Gates filed a notice of appeal on July 13, 1966 (Rec. 713-714). The grounds for this appeal were exhaustively litigated by Gates at trial.

## ARGUMENT

### POINT I

**The Trial Court was correct in holding the 1960 and 1961 contracts between Gates and Collier enforceable and not proved to be in violation of the Japanese Foreign Exchange Law.**

Up to April 15, 1960 Gates Company bought encyclopedias from Collier for \$69 a set and resold them in Japan for its own account. Thereafter, pursuant to the 1960 and 1961 contracts (PX 1, PX 2), Gates sold these encyclopedias for Collier's account through Collier's Tokyo branch. With this change, Collier duly applied for and received from the Japanese government an import license as required by the Japanese Foreign Exchange and Foreign Control Law, permitting Collier to convert from Japanese yen into American dollars and to send out of Japan to Collier's New York office \$172.50 of the gross sale price (\$269.50) of every set of encyclopedias sold in Japan. The import license was granted for \$172.50 per set, allowing Collier to receive dollars in New York for books sent to Japan. (Rec. 690, 691, 700-702.)

Gates contends that his contracts with Collier (PX 1, PX 2) intentionally violated the Japanese Foreign Exchange Law (PX 98). Gates argues (App. Br. pp. 17-22) that the "cost" of the encyclopedias to Collier was not \$172.50 per set, that this figure was allegedly "padded" by Collier to evade Japanese Foreign Exchange Law restrictions on currency outflow from Japan and that he was entitled to a portion of every \$172.50 allowed out of Japan under the import licenses. Gates concludes that this

purported but unproved procedure and transfer of his funds from Japan to New York under contracts with Collier violated the Japanese Foreign Exchange Law and renders the contracts void. Gates then presses the notion that he, not Collier, should recover for his services to Collier (App. Br. pp. 15-22, 26-32).

The Trial Court rejected this contention on the ground that Gates did not prove the Japanese Foreign Exchange Law (Rec. 703-704, 705).\*

At trial, Gates introduced into evidence the bare statutory text of the Japanese Foreign Exchange Law (PX 98). He did not introduce any testimony by a member of the Japanese bar as to the meaning of the statute or its application or effect in the circumstances of this case. He did not introduce any judicial decisions or administrative opinions or regulations interpreting or implementing the Japanese Foreign Exchange Law. Nevertheless, Gates (Br. pp. 15-26) urges this Court to reverse the Trial Court's judgment because of his empty claim that the record shows that the 1960 and 1961 contracts violated the Japanese Foreign Exchange Law and are accordingly void.

The Trial Court properly rejected this contention, judicially noticing that

“\* \* \* there must be Japanese cases or administrative opinions which set out and construe the definitions, restrictions and prohibitions [in the Japanese Foreign Exchange Law] referred to [by

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\* The Trial Court also ruled that Gates did not sustain his burden of proving (1) what the actual “cost” to Collier of a set of encyclopedias *was* under the contracts; (2) that *any* of the \$172.50 per set allowed out of Japan under the import licenses was unconditionally due and owing to Gates when it left Japan; or (3) that the Japanese government had ever taken any action against Collier for violation of the Japanese Foreign Exchange Law (Rec. 700-705).



Gates]. \* \* \* It is impossible for this court to determine the legal application of the broad words of that law to the particular facts of this case, in the absence of proof by Japan case law or administrative opinion. \* \* \* [P]laintiff has not proved the judicial interpretation and legal effect of the Japanese law to the particular facts of this case and this court cannot find that the contract was illegal and void." (Rec. 703-704, 705)

In *Dulles v. Katamoto*, 256 F. 2d 545, 547 (9th Cir. 1958), this Court said:

"We judicially recognize that Japan is a civilized state having a constitution, a legislative body, with its statutes, courts administering laws with lawyers and judicial decisions \* \* \*."

The party seeking to prove Japanese law has a "heavy burden of proof". *Id.* at 548. The "usual method of proof of a foreign law [is] by the testimony of an experienced Japanese practitioner." *Id.* at 547. Indeed, a party's failure to sustain its heavy burden of proof of Japanese law "makes its contention open to the inference" that the Japanese law, if properly proved, would sustain the position of the *opposing* party. *Ibid.*

Gates could not sustain his burden of proof by mere introduction of the broad and ambiguous Japanese Foreign Exchange Law text:

"The party relying on foreign law has the burden of proof. It must establish precisely what that law is and how it is interpreted. \* \* \* A mere translation of a foreign statute without more, without the background, without the context or the area of internal application is insufficient. *Usatorre v. The Victoria*, 2 Cir., 1949, 172 F. 2d 434. In particular the specific portion of potential appli-



capability contains ambiguities which a United States Court is not competent to resolve." *Application of Chase Manhattan Bank*, 191 F. Supp. 206, 209 (S.D.N.Y. 1961), *on rehearing* 192 F. Supp. 817 (S.D.N.Y. 1961), *aff'd* 297 F. 2d 611 (2d Cir. 1962).

The Trial Court's findings have ample support in the record and, we submit, should not be disturbed by this Court. Rule 52(a), F.R.Civ.P.; 5 MOORE, FEDERAL PRACTICE, ¶52.03 [1], p. 2616 (1964). Gates did not carry, as he must, his burden of proof of the Japanese Foreign Exchange Law. Accordingly his arguments for reversal based on that foreign statute must fail.

## POINT II

**The Trial Court should be affirmed in its finding that Gates committed fraud and breached his 1960 and 1961 contracts, since New York, not Japanese, law governed questions of fraud and breach of contract.**

Collier's defenses and first two counterclaims sound in tort (fraud and breach of fiduciary duty) and contract (Rec. 28-32). The Trial Court found that Gates defrauded Collier and breached his contractual as well as his fiduciary duty toward Collier (Rec. 696-697, 698). Gates contends reversible error on the ground that such issues are governed by Japanese law, unproved at trial by Collier (App. Br. pp. 33-39).

But the law of New York properly applies to the issues of Gates' fraud and breach of contract. Accordingly, there was no necessity for Collier to prove the law of Japan to establish its defenses and counterclaims.

The Trial Court found these facts (Rec. 688-694, 696):

"Defendant Collier [is] a Delaware corporation with its principal office in New York \* \* \*. \* \* \* Gates came to New York in March of 1960 and entered into a personal contract with Collier, dated April 15, 1960 \* \* \*. Orders obtained by Gates and his sales personnel were to be forwarded to Collier in New York for acceptance by Collier, there. \* \* \* Collier was to ship, at its own expense, such books as were required for sales in Japan, to Gates' warehouse in Tokyo. \* \* \* All military orders were to be shipped by Collier's New York office to the purchasers. \* \* \* All accounts sold by Gates in Japan were to be the accounts receivable of Collier. \* \* \* Dollars collected in Tokyo were to be remitted directly to New York. The amount remitted to Collier in New York on yen collected was to be the amount as limited by Collier's Import License. \* \* \* So that Gates could be paid immediately the commission on the dollar accounts, Collier established an "Imprest Fund" with the Long Island Trust Company in New York, on which Gates had the power of attorney and from which he could draw to pay his sales commission. \* \* \* Collier paid all legal, tax and other expenses for setting up the Tokyo branch of its corporation, and applied for and received a Japanese Import License so that Collier in New York could be paid for all of the books sent to the Japan office. \* \* \* The contract was agreed upon in New York while Gates was there. Collier signed it in New York and Gates signed it in Tokyo. Both parties operated under the above contract until September 15, 1961, when a new agreement was entered into whereby Gates became 'Supervisor of the Asiatic Division of Collier' with the same obligations, duties, etc. \* \* \*.

\* \* \* \* \*

"On [April 26, 1962] \* \* \* Gates \* \* \* exhibited [to Bennett and Van Arsdale] three ledgers (Exs. B13—A, B and C) representing that his Japanese bookkeepers had contrived a system of reporting to New York only selectively the money collected \* \* \*. The ledgers show that immediately after the April 1960 contract had gone into effect, i.e., beginning May 4, 1960, Gates set up a scheme of embezzlement whereby he falsely and fraudulently reported to Collier the COD and cash sales to Japanese civilians as having been term sales, thus taking for himself not only the full amount of commissions to which he might be entitled but also all of that portion of the sale which became immediately due to Collier. \* \* \* [T]he ledger indicated that the names and addresses of the purported purchasers on term sales orders, as sent into Collier in New York, were not the true purchasers, but were relatives and friends of Gates and his staff who were given instructions to send any auditors' letters back to Gates Co. for answering.

"In 1963, Gates moved \* \* \* to Hawaii, and in July 1964 filed this diversity action for \* \* \* \$367,000 \* \* \*."

The Trial Court, in a diversity case, was obligated to apply Hawaiian conflict of laws rules to determine whether New York or Japanese law governed the choice of law applicable to Gates' fraud and breach of contract. *Eric R.R. Co. v. Tompkins*, 304 U. S. 64 (1938); *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U. S. 487 (1941); *Sampson v. Channell*, 110 F. 2d 754 (1st Cir. 1940), *cert. denied* 310 U. S. 650 (1940). But there are no Hawaiian cases defining rules pertinent to these issues (Tr. 484; Rec. 486). Hence, the Trial Court looked to general conflict of laws principles enunciated by courts in sister states to determine what rule the Supreme Court of Hawaii, the forum

state, would apply if this case were before it. *Mansfield Hardwood Lumber Co. v. Johnson*, 268 F. 2d 317, 319 (5th Cir. 1959), *cert. denied* 361 U. S. 885 (1959), *rehearing denied* 361 U. S. 926 (1959).

At the trial, the Court indicated that it would look to the "center of gravity" or "grouping of significant contacts" rule to determine whether the law of New York or that of Japan applied to this case (Tr. 484-489). That the Trial Court concluded New York law was applicable appears from the fact that the Court made its findings of fraud and breach of contract without requiring any proof of Japanese law (Rec. 696-697, 698) and specifically applied New York law to damage aspects of the case (Rec. 710 and fn. 16). We submit that the Trial Court was correct in applying New York law to the issues of Gates' fraud and breach of contract.

**The Rule in Tort Cases.** In *Kemart Corp. v. Printing Arts Research Lab., Inc.*, 269 F. 2d 375 (9th Cir. 1959), *cert. denied* 361 U. S. 893 (1959), this Court considered a similar situation—absence of an applicable state conflict of laws rule indicating which jurisdiction's substantive law should govern a tort case. 269 F. 2d at 392. This Court held that the substantive law of the state with the closest relationship to the parties involved in the litigation and the strongest contacts with the subject matter of the litigation should govern. *Id.* at 392-393, and see fn. 12. This Court cited *Lauritzen v. Larsen*, 345 U. S. 571, 582 (1953), a tort case in which the United States Supreme Court noted that

"\* \* \* our municipal law has attempted to avoid or resolve conflicts between competing laws by ascertaining and valuing points of contact between the transaction and the states or governments whose competing laws are involved."

See also 345 U. S. pp. 583-593.

Factors considered by this Court in applying the rule in *Kemart* were: (1) principal place of business of the parties; (2) the state where the publications complained of (this was a defamation action) were received and read, as opposed to their place of origin; (3) the state where the damage or injury was suffered. *Id.* at 392.

**The Rule in Contract Cases.** Strong authority exists for application of the "center of gravity" or "grouping of contacts" rule to determine which jurisdiction's substantive law governs a contract and questions of its breach. *Lilienthal v. Kaufman*, 239 Ore. 1, 395 P. 2d 543, 545-546 (majority), 552-553 (dissent) (1964); *Kievit v. Loyal Protective Life Ins. Co.*, 34 N. J. 475, 170 A. 2d 22, 32 (1961); *Boston Law Book Co. v. Hathorn*, 119 Vt. 416, 127 A. 2d 120, 125 (1956); *Auten v. Auten*, 308 N. Y. 155, 124 N.E. 2d 99, 101-102 (1954); *Jansson v. Swedish American Line*, 185 F. 2d 212, 218-219 (1st Cir. 1950); *W. H. Barber Co. v. Hughes*, 223 Ind. 570, 63 N.E. 2d 417, 423 (1945). Under this rule, a court will apply to a contract the substantive law of the state which has the most significant contacts with the case and

"\* \* \* the greatest concern in defining and regulating the rights and duties existing under that agreement, and, specifically, in determining the circumstances that effect a termination or repudiation of the agreement." *Auten v. Auten, supra*, 124 N.E. 2d at 103.

Factors which the courts in the above cases have considered in applying this rule are: (1) citizenship of the parties; (2) place of negotiation, drafting and execution of the contract; (3) place where the party damaged by the breach would have received payment if the contract had been fully performed.

Here, the record and the Trial Court's findings of fact quoted above reveal that New York is the jurisdiction having the most significant contacts with this case and the most intimate concern with its outcome. Collier had its principal place of business in New York; Gates, while not a New York domiciliary, was a citizen of the United States and not of Japan; Gates and Collier negotiated the original contract in New York and both contracts were drafted in New York, in English, and executed by Collier in New York; Gates was to send all orders to Collier's New York office, for acceptance by Collier there, and was to send accurate reports and proper remittances of money collected to Collier's New York office; Gates sent the false and fraudulent orders and reports and the incorrect remittances to Collier's New York office, where Collier relied on them and was injured.

These facts and the applicable rules of law warrant the conclusion that New York law applies to the issues of Gates' fraud and breach of fiduciary duty and contract.\* The Trial Court's findings in this regard are also correct and should be affirmed.

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\* Since this was obviously not a criminal case, the Trial Court's use of the word "embezzlement" to characterize Gates' conduct is simply employment of the term in its generic sense to describe Gates' fraud and breach of his fiduciary duty to pay or account to Collier for money in Gates' possession but belonging to Collier. *Champion Ice Mfg. & Cold Storage Co. v. American Bonding & Trust Co.*, 115 Ky. 863, 75 S.W. 197, 198 (1903).

### POINT III

**The Court below was correct in finding the Collier-Gates relationship terminated on May 2, 1962.**

The Trial Court found that *all* Collier-Gates contracts were terminated as of May 2, 1962 (Rec. 697). Gates urges, however, that the contractual arrangement between the parties should be viewed by this Court as four divisible or separable contracts and that the termination notice given by Collier on May 2, 1962 served to terminate only the Japanese civilian (97B) and Japanese school (99B) aspects of the agreement. Under New York law, the question of divisibility of contracts is a question of the intent of the parties to be determined by the trier of facts. *Clark v. West*, 137 App. Div. 23, 122 N. Y. Supp. 380 (2d Dep't 1910), *aff'd* 201 N. Y. 569, 95 N.E. 1125 (1911); *Ming v. Corbin*, 142 N. Y. 334, 37 N.E. 105 (1894). In its Amended Decision, the trier of facts found:

“This court has already indicated orally from the bench and now states again that the three ledgers (Exs. B13-A, B and C) on their face show that as of May 13, 1960, Gates began embezzling monies due Collier under the first contract and continued such embezzlements until Bennett discharged him as Collier's representative in Japan and took over the business on May 2, 1962. The two weeks' notice provided by the contract was obviously intended to apply to a voluntary termination of the contract—without involving any such gross and criminal breach thereof, as found here. By May 2, 1962, Bennett had before him clear and positive proof of Gates' fraud. Bennett's letter of discharge on May 2 and his acts immediately thereafter constituted ample notice to Gates that the contracts



were forthwith terminated, and for what reason. Nork's actions in Australia, likewise gave the same notice. Under the factual circumstances, the two weeks' notice referred to in the contract had no application. The breach by Gates was so substantial and fundamental as to completely destroy the personalized foundation of the contracts and negated any possibility of Gates being permitted to continue to run Collier's Japan and Australian operations. Failure to terminate promptly after discovery of Gates' fraud would have waived the breach. All Collier-Gates contracts were terminated as of May 2, 1962." (Rec. 696-697).

Thus, in accord with Collier's contention that the different *aspects* of the contract were separated for accounting purposes, the Trial Court determined that Gates' breach was a breach of the entire indivisible contract.

Moreover, Gates misconstrues why the Trial Court found that Gates owes Collier \$169,013. Collier's Exhibit R-48, the summary of the account between the parties, was based on an assumption of *no fraud* by Gates. This amount would have been due from Gates to Collier had the contract been terminated on May 2, 1962 without proof of fraud on Gates' part. As the Trial Court held:

"\* \* \* defendant had an exhaustive study of all of the Gates' Japan and Australian accounts made by Rabinowitz. In his calculations, Rabinowitz gave Gates full credit for all sales up to and including May 2, *as if Gates had not committed fraud and embezzlement*. His calculations, *made on a basis most favorable to Gates*, showed that out of gross sales of over \$1,069,549, Gates' liability under the 12.5% clause for the 96B-Military and 97B-Japan civilian accounts, as well as the 10% liability clause on 99B-Japan schools accounts was



\$185,822. Only the Australian accounts reflected a credit due Gates on term business. As indicated by the calculations of Rabinowitz, Gates still owes Collier \$169,013 under the contracts." (Rec. 699-700) (emphasis added).

Collier's extensive proof of Gates' fraud warranted the finding of the Trial Court that all Gates' contracts with Collier were justifiably terminated on May 2, 1962 without the need for two weeks' notice.

#### POINT IV

**Since the attorneys' fees and travel expenses were the proximate result of Gates' fraud, the Trial Court properly exercised its discretion in awarding those fees and expenses to Collier.**

Federal courts, hearing cases based on diversity jurisdiction, may award counsel fees. *Universal Oil Co. v. Root Rfg. Co.*, 328 U. S. 575 (1946); *Sprague v. Ticonic Bank*, 307 U. S. 161 (1939); *Dodge v. Tulleys*, 144 U. S. 451 (1892).

This Court has followed this equitable policy, allowing attorneys' fees in its discretion. In *Bank of China v. Wells Fargo Bank & Union Trust Co.*, 104 F. Supp. 59 (N.D. Cal. 1952), *aff'd* 209 F. 2d 467 (9th Cir. 1953), the Court stated that it was

"\* \* \* not unmindful that since *Erie R. Co. v. Tompkins*, \* \* \* a number of federal courts have indicated that in a diversity case a federal court should follow the state practice in respect to the allowance of attorney's fees. \* \* \* Concededly under California law, attorney's fees are not allowable in actions in the nature of interpleader. \* \* \* But, the

Court adheres to the view which it expressed in *Kellems v. California CIO Council*, D.C. 1946, 6 F.R.D. 358, 361, that Rule 54(d) of the Federal Rules of Civil Procedure vests a discretionary power in the court with respect to the allowance of costs, including the attorney's fees, the exercise of which cannot be curtailed by state legislation." 104 F. Supp. at 67-68.

The Ninth Circuit affirmed and stated that:

"The allowance of costs, including attorney's fees, is a matter within the discretion of the trial court and will not be disturbed unless an abuse of that discretion is clearly shown." 209 F. 2d at 476.

## CONCLUSION

**The judgment of the Trial Court should be affirmed.**

Dated: November 21, 1966.

Respectfully submitted,

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**Certificate**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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